DESCRIPTION OF S. 1713

Relating to

INCOME TAX TREATMENT OF SALES OF FARMLAND DEVELOPMENT RIGHTS TO A STATE OR LOCAL GOVERNMENT UNDER A QUALIFIED FARMLAND PRESERVATION PROGRAM

Scheduled for a Hearing
Before the

Subcommittee on Energy and Agricultural Taxation

of the

Committee on Finance

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INTRODUCTION

The Senate Finance Subcommittee on Energy and Agricultural Taxation has scheduled a hearing on S. 1713 (sponsored by Senators Mathias, Sarbanes, Hatfield, Jackson, and Kasten) on May 24, 1982. The bill deals with tax treatment of sales of farmland development rights to State and local governments under qualified farmland preservation programs.

The first part of the document is a summary of the bill. The second part is a description of the bill, including present law, issues, explanation of provisions, effective dates, and revenue effects.

I. SUMMARY OF THE BILL

There are no provisions in present law specifically governing the tax consequences of sales of farmland development rights for purposes of preserving farmland. However, generally applicable provisions of present law may provide favorable income tax treatment for such transactions. For example, gain from the exchange of farmland (or interests in farmland) is not recognized in the case of a like-kind exchange for similar property (Code sec. 1031), and gain from the exchange or disposition of farmland in an involuntary conversion is not recognized if the owner receives similarly used property or reinvests the proceeds from the involuntarily converted property in such similarly used property (sec. 1033). In addition, gain realized on sale of a farm residence which is the taxpayer's principal residence may qualify for nonrecognition treatment if the proceeds are invested in another such residence (sec. 1034), or for an exclusion from income of up to $125,000 of such gain in the case of an individual who has attained age 55 (sec. 121). Also, under present law, charitable deductions are permitted for contributions to qualified organizations of farmland or conservation easements in farmland (sec. 170).

S. 1713 would provide special rules for nonrecognition of gain realized from the sale of farmland development rights to a State or local government under a qualified farmland preservation program if the proceeds were reinvested in property used for farming purposes. The bill also would provide a limited exclusion from income of up to $100,000 of gain from such a sale by an individual who had attained age 55. In addition, the bill would permit a charitable deduction for the excess of the fair market value of farmland development rights over the gain from sale of those rights to a State or local government under a qualified farmland preservation program.

The provisions of the bill would apply to sales of farmland development rights after 1980.

II. DESCRIPTION OF THE BILL

A. Rollover of gain from sale of farmland development rights

Present Law

There is no provision in present law specifically providing for nonrecognition of gain realized from the sale or other disposition of farmland development rights. However, gain from the sale of farm property is not recognized in several general situations under present law.

First, present law provides for nonrecognition of gain realized in an exchange of property held for productive use or investment for property of a like kind, also to be held for productive use or investment ("like-kind" exchanges) (Code sec. 1031). Thus, property used for farming purposes may be exchanged for other similarly used property without recognition of gain except to the extent that money or other property is received in the exchange.

Second, present law provides for nonrecognition of gain realized from an involuntary conversion of property (sec. 1033). Under this provision, for example, gain realized on condemnation of property, or gain from insurance proceeds resulting from the destruction of property by fire or theft, is not recognized to the extent that the funds received are invested in property "similar or related in service or use" to the converted property within two years after close of the taxable year in which the gain is realized. Likewise, if property is involuntarily converted directly in exchange for other similarly used property, no gain is recognized.

Third, present law provides for nonrecognition of gain realized from the sale of a principal residence, including a farm residence, in certain circumstances (sec. 1034). The taxpayer must purchase and use a new principal residence within the period beginning two years before and ending two years after the sale of the old residence. Additionally, the gain is not recognized only to the extent that the cost of purchasing the new residence equals or exceeds the adjusted sales price of the old residence.

Issue

The issue is whether gain from the qualified sale of farmland development rights should be deferred if the farm owner reinvests the sale proceeds in other property used for farming purposes.

Explanation of Provision

Under the bill, if certain requirements are satisfied, owners of farmland could sell the development rights to the land to a State or local government under a qualified farmland preservation program without recognizing taxable gain from the transaction. A qualified farmland preservation program would be a program established under State or local law that provides for the purchase of farmland development rights by a State or local government in order to assure that property devoted to farming purposes continued to be used for those purposes.

No gain would be recognized by the seller to the extent that within the period beginning 18 months before and ending 18 months after the sale, the seller purchased "qualified farming property." Qualified farming property would include real property, improvements to real property, and any asset chargeable to capital account used for farming purposes. Thus, under the bill, if an owner of farmland sold development rights and bought additional farmland or other farm property, such as a new barn or a tractor, for an amount at least as great as the gain on the sale of the development rights, none of the gain would be recognized for income tax purposes.

If the cost of the replacement property did not equal the amount realized on the sale of the development rights, gain would be recognized to the extent amounts were not reinvested. If the qualified farming property purchased with the proceeds of the sale of development rights were used for purposes other than farming (i.e., converted to another use) within the five-year period beginning on the date of the sale of development rights, the previously unrecognized gain would be included in the property owner's income in the year the property was so converted.

Effective Date

This provision of the bill would apply to sales of farmland development rights occurring after 1980.

B. One-time exclusion from income of gain from sale of farmland development rights

Present Law

There is no provision in present law specifically providing for exclusion from income of gain realized from the sale of farmland development rights. Present law does, however, permit exclusion of up to $125,000 of gain realized from the sale of a principal residence, including a farm residence, by an individual who has attained the age of 55 and meets certain other requirements (sec. 121). 1/ This exclusion is elective by the taxpayer, and is available for only one sale or exchange by the taxpayer or the taxpayer's spouse.

Issue

The issue is whether individuals who have attained age 55 should be permitted to exclude from income certain gain realized on the sale of farmland development rights.

Explanation of Provision

Under the bill, an owner of farmland who has attained age 55 could exclude up to $100,000 2/ of gain from the sale of farmland development rights to a State or local government under a qualified farmland preservation program. A qualified farmland preservation program would be a program established under State or local law that provided for the purchase of farmland development rights to assure continued use of the land for farming purposes.

The exclusion would be available only if the seller had owned, and used for farming purposes, the farmland for which development rights were sold for periods aggregating three years or more of the five-year period ending on the date of the sale. The exclusion would apply to only one sale by the taxpayer or the taxpayer's spouse.

Effective Date

This provision of the bill would apply to sales of farmland development rights after 1980.

1/ The maximum exclusion is $62,500 in the case of a married individual filing a separate return.

2/ The maximum exclusion would be $50,000 in the case of a married individual filing a separate return.

C. Charitable contribution deduction for gain foregone by reason of sale of farmland development rights

Present Law

Subject to certain limits, present law allows an income tax deduction for the value of property transferred for charitable purposes (sec. 170). State and local governments are qualified recipients of deductible charitable gifts if the gifts are to be used exclusively for public purposes. The amount of the charitable deduction is generally the fair market value of the contributed property on the date of the gift. 1/

In the case of a "bargain sale" (i.e., a sale for less than fair market value), the deduction is generally equal to the excess of the fair market value of the property over the sales proceeds. Additionally, in the case of a bargain sale, the donor/seller of the property is required to allocate his basis in the property between the sale and gift portions of the transfer in determining the gain from the sale (sec. 1011(b)).

In general, no charitable deduction is allowed for transfers of less than the entire interest in property owned by the transferor unless the transfer is in certain specified forms, including a qualified conservation contribution (sec. 170(f)). A qualified conservation contribution includes an easement or other restriction granted in perpetuity, which, among other purposes, acts to preserve open space (including farmland) for scenic enjoyment of the general public or pursuant to a clear Federal, State, or local government conservation policy and will yield a significant public benefit. Thus, present law permits a charitable deduction for a gift in perpetuity of farmland development rights to State and local governments if the gift is pursuant to a clearly defined governmental conservation policy and yields a significant public benefit. These deductions are allowable for income, estate, and gift tax purposes.

1/ Under present law, the deduction otherwise allowable for charitable contributions must be reduced in certain cases. Among these reductions are the portion of the unrealized gain on the property that would have been ordinary income had the donor sold the property, certain portions of that amount which would have been capital gain had the property been sold (in the case of gifts of tangible personal property for certain used or gifts to certain private foundations), and certain interest (secs. 170(e) and (f)).

Issue

The issue is whether an income tax deduction should be allowed for contributions of farmland development rights to State and local governments when the contributions do not qualify as qualified conservation contributions, for example, because the development rights are not transferred in perpetuity.

Explanation of Provision

The bill would allow a taxpayer who sells farmland development rights to a State or local government under a qualified farmland preservation program to claim a charitable deduction for income tax purposes equal to the excess of the fair market value of the farmland development rights over the gain realized 2/ on the sale. 3/ Thus, an income tax charitable deduction for certain bargain sales of farmland development rights would be allowed whether or not the requirements for a charitable deduction for qualified conservation contributions (sec. 170(f)(3)) were satisfied.

Effective Date

This provision of the bill would apply to sales of farmland development rights after 1980.

D. Revenue effects

It is estimated that this bill will reduce Federal budget receipts by $25 million annually.

2/ Under the general rules for determining the amount of charitable deduction on a bargain sale, it appears that the measure of the contribution should be the fair market value of the development rights over the amount realized on the sale (rather than over the gain realized on the sale).

3/ A qualified farmland preservation program would be a program under which a State or local government purchased farmland to assure its continued use for farming purposes.